Profits Under Nazi Planning
Author(s): Arthur Scheweitzer
Source: *The Quarterly Journal of Economics*, Vol. 61, No. 1 (Nov., 1946), pp. 1-25
Published by: Oxford University Press
Stable URL: http://www.jstor.org/stable/1882401
Accessed: 09/06/2014 22:52

THE
QUARTERLY JOURNAL
OF
ECONOMICS

NOVEMBER, 1946

PROFITS UNDER NAZI PLANNING[1]

SUMMARY

Early developments: partial planning, 1. — Shift to central planning, 2. — Results, 3. — The rôle of profits, 4. — Supplementary inducements, 5. — Control of investment incomes, 7. — Results, 9. — Control of profit margins: equalization, 10; manipulation, 11; determination, 12. — Results, 14. — The abortive profit ceiling, 16. — Results, 18. — Profit incentives in price control, 19. — Subsidies, 21. — Results, 22. — General conclusions, 24.

It is commonly assumed that central economic planning and profitability of business are incompatible: either comprehensive economic planning without a profit system or business for profit but no central planning must prevail. A study of the Nazi economy, however, reveals that for the first time profitability of business became compatible with central economic planning. This raises two interesting questions: What were the main features of fascist economic planning; how were the principles of both profit and planning modified and integrated effectively in the economy?

Economic Planning

The Nazis practiced extensive partial planning from the fall of 1936 to the middle of 1942, and central planning for the last period of the regime. The government had introduced central planning at the beginning of the war, through the decrees of August and September, 1939. Consumption and income of civilians were reduced; the working week was generally raised to 60 hours; compensation for "overtime" and other bonuses had to be paid as a tax to the treasury. But the quick success in the Polish campaign

1. The present paper is part of a research project on government and business under the Nazis conducted by the School of Business, University of Chicago.

led to a repeal or modification of the original plans for total economic mobilization. The plans for concentrating production in large plants were shelved; small and middle-sized plants were incorporated in the military sector through dispersal of orders.[2] In fact, partial mobilization replaced the original blueprints for central planning and total mobilization.

Partial planning was predicated upon "lightning" military campaigns. On the one hand, this form of warfare minimized the military demands upon the economy. The short periods of attack limited both the material used by the conquering forces and the destruction of properties by the opponents in the campaign. This form of warfare, deliberately devised by the Nazis, fitted the situation of Germany with her limited resources, and opened the opportunity for maximum gains in war booty. The military superiority of the German armed forces could be exploited without exhausting their own economy; victory could be secured without devastating the economies of conquered lands, destined to be a part of the fascist empire. On the other hand, the periods of lull set off the various campaigns from each other, defined the specific tasks for planning, and provided a valuable period of economic preparation for the campaign. The reduced scope of military requirements and well-defined tasks for war production made economic planning predictable and manageable. In consequence, the specific economic planning for brief campaigns dispensed with the need for an overall economic plan of many years duration, and planning for war was reduced to the proportions of a series of partial plans.

But when Allied military action imposed a war of attrition upon Germany, the Nazis had to shift to total economic mobilization for an all-out war. Central planning was the means by which they hoped to realize this goal. Relative to the previous economic performance, total mobilization was a success. The index of finished armament production rose from 100 in 1942 to 322 in July, 1944.[3] The number of aircraft produced yearly increased from 8,200 in 1939 to almost 40,000 in 1944. Simultaneously, consumption fell considerably. Civilian consumption of

2. Georg Wolff, "Mittel- und Kleinbetriebe im Kriege," Wirtschaftskurve, February, 1940.

3. Rolf Wagenfuhr, Deutschlands Kriegswirtschaft, 1939–45, captured manuscript, quoted in U. S. Strategic Bombing Survey, The Effects of Strategic Bombing on the German War Economy, Washington, 1945.

leather and leather substitutes for shoe manufacture and repair declined by 55 per cent between 1938–39 and 1943–44. Of the shoes still produced in 1944, civilians received only 28 per cent, as compared with 64 per cent in 1938–39. In January, 1945, the daily ration for "normal" consumers had a total content of 1,721 calories. This was almost 300 units below the minimum emergency level of consumption, and only a little above the ration set by the American Military Government after the occupation. The expansion of the military and reduction of the civilian economy are the more remarkable because Germany had neither idle facilities nor large consumer goods industries as a source of war production. Total mobilization was achieved on the basis of full employment. It was secured through the extensive utilization of the resources of the Empire and reduction of the civilian economy.

How effective was central planning under the Nazis? It is too early to tell the whole story and examine its effects, but three facts are beyond doubt.[4] First, central planning came two years too late. Considering the major task of total mobilization for defeating Russia before the United States could become an effective belligerent, central planning should have been instituted in 1940, instead of 1942. Second, central planning was coupled with the task of a partial reorganization of business. The available resources and facilities for production of armaments had to be increased through an extensive rationalization and efficiency drive within business units, through a shift of labor and machinery to the most efficient plants and the laying-off of others, and through reduced production of civilian goods. The fairly large success of these efforts increased the available resources, but also changed continually the conditions for central planning. Third, the realization of plans was increasingly disturbed and upset by Allied air attacks. Endangered or bombed plants called for dispersal of essential factories. Bombing of cities led to the uneconomical use of labor in the clearing and repair of bombed areas. Bombardment also limited the extent to which consumption could be reduced because of the losses of consumer goods by air attacks. In consequence of the last two factors, central planning had to take place under a high degree of

4. The shift from partial to central planning did not initiate a change in the power relationships between government and business. The party continued to be the major, big business the minor, holders of power. Cf. Arthur Schweitzer, "Big Business and the Nazi Party in Germany," Journal of Business, January, 1946.

uncertainty and be executed under the most unfavorable conditions.

Present information, however, does not justify the conclusion that central planning was one of the major reasons for the collapse of the German economy. Instead, two causes led to the quick disintegration of the economy: the loss of the resources of the empire; the increasing effectiveness and devastation of the Allied air attack.

What was the rôle of economic planning in the Nazi economy? Clearly, it was one of the new features introduced by the Nazis into the German economy. Reduced to its essentials, it involved basic changes in the traditional economy in important respects. First, economic freedom was replaced by the principle of universal obligation to work in accordance with governmental instructions (Arbeits- und Wirtschaftspflicht). Second, trading in private markets was replaced by comprehensive governmental regulation of almost all markets in the economy. Third, freedom of association was displaced in favor of compulsory business organizations and effective operation of governmental agencies in business. Finally, the function of unconscious direction of the economy through the profit motive was taken over by economic planning of activities by the government.

The Rôle of Profits

The profit situation after 1936 was characterized by two strange paradoxes. On the one hand, the Nazis gradually suppressed the profit motive but retained profit as a stimulus for producers to increase output and achieve efficiency. On the other hand, government price control determined the permissible profit margins in fixed prices but still offered opportunities for businessmen to realize substantial total profits each year. These contradictions produced two problems. How and why did the Nazis sever the profit motive from the profit stimulus? What was the effect of extensive governmental price fixing upon the rôle and use of realized profits in the economy?

In private capitalism the profit motive is a powerful force. In the sphere of production it performs at least two functions. The one affects the actions of producers; the other influences the general course of the economy. Actual or expected profit opportunities constitute incentives for owners to reinvest their capital,

increase output, improve efficiency of production. These incentives enlarge the opportunities and modify the prevailing conditions within operative plants. In addition the profit motive affects the relationship between firms and industries: actual or expected differences in the rate of profit between firms and industries induce owners to redirect their capital from less to more profitable fields of production. This shifting of capital and employment has an effect not consciously sought; it determines the total volume of business and directs the general course of economic activities.

The Nazis refused to accept these traditional functions of the profit motive. On the contrary, they effectively separated its two functions in production. Profit as a stimulus for private owners was retained but greatly modified. Profit as a guide for the general direction of the economy was suppressed, and its place was taken by the economic plans of the government.

Governmental planning set the prime goals for the economic activities of persons and firms. Governmental agencies, implementing plans, allocated factors of production among concerns and industries. Commissions and inspectors reduced the civilian industries in favor of war industries. Innumerable agencies regulated the exchange of all products, services, and almost all property titles. The general direction of the economy was no longer left to the profit motive. The course of economic activity was planned and directed by governmental agencies.

What happened to profits as a stimulus for producers? As usual in major decisions, a conflict arose between party leaders and big business. Leaders of big business favored the full operation of the profit motive. Party leaders desired intensified production, but insisted upon extensive control of all forms of profits. Under the increasing pressure for efficiency, neither of the rivals carried his point. The resultant compromise led to the incorporation of profit and other supplementary inducements into a system of profit fixing.

The two outstanding supplementary inducements introduced by the Nazis were the contests among enterprises for the title of a "model firm" and payments of prizes and bonuses for special achievements in production. The idea of a national competition among firms for the title of a model firm originated in the Labor Front. It was the means by which this party organization induced employers and employees to accept, and operate through, its

division of "Strength through Joy." The winning firms were selected according to their ability to (a) maintain social peace, (b) provide welfare schemes for their employees, (c) increase the productivity of labor, (d) and follow closely the Nazi economic policies. During the war, however, the last two criteria alone became relevant. Most of the welfare schemes were discontinued. Maintaining social peace became a responsibility of the Labor Front and the Secret Police. Of equal significance in selection of contesting firms became the ability of plants to utilize raw materials and equipment efficiently. In 1941 a total of 290,322 enterprises participated in the contest; 119 were chosen as model firms; 2,000 received regional diplomas; and 3,583 obtained rewards of achievements for more than average efficiency.[5]

The bonus system fostered a variety of activities. Suggestions for improvement of production methods or discoveries of new processes brought many a foreman and manager a small bonus. Replacement of scarce by more plentiful materials carried governmental premium payments (e.g. timber bonus). Prizes were paid to firms which introduced new labor-saving machines. During the war, however, cash payments did not incite many to special achievements. Hence premiums were granted in kind. Firms that utilized coal sparingly were permitted to store a two-months supply for their own use. Plants conserving scrap were given a preference for speedy delivery of allocated materials. Efficient management was a recommendation for being granted a lease of a sequestered enterprise in occupied lands. For effective managers were at a premium and special management schools tried in vain to satisfy the most urgent demand.

The special inducements had a limited success. The national contests among enterprises, at first a mere political propaganda stunt, became general drives for increased output, improved efficiency, and conservation of resources. The winning firms increased their chances of receiving the favorable attention of regulating governmental agencies. Such special consideration became increasingly important when the contests were followed by drives to close the inefficient plants and shift the skilled laborers from the less to the more efficient concerns. Prizes and premiums had a similar effect for the winners. For premiums did not conflict

5. "Leistungskampf der deutschen Betriebe," Soziale Praxis, 1941, p. 549.

with government plans. They became recognized devices to break bottlenecks. Prizes stimulated firms to special achievements in fields in which accomplishment threatened to fall short of government plans. Consequently, contests and premiums were incorporated in the production and rationalization plans of the government.

However effective in implementing plans, the special inducements did not replace the profit stimulus for producers, as some Nazis desired. Fixing of profits, not their suppression, was the official policy of the Nazi party. Government profit fixing tried to impose three different lines of action upon owners. First, profits usually spent in consumption were reduced in favor of profits invested in governmentally desired projects. Second, the rates of profit between firms and industries were manipulated in order to equalize the rate of profit among desired activities and discriminate against the primarily civilian industries. Third, a significant attempt was made to establish a general profit ceiling that was to supplement the policy of fixing profit margins through price control. How far were these profit policies of the Nazis successful?

Control of Investment Incomes

The Nazi government effectively discriminated against the rentiers, who usually spend a relatively large portion of their property income for consumption. Dividends, interests, and rents were deliberately depressed. The various rates of interest were greatly reduced. The yield of long-term government bonds declined from 7 per cent in 1933 to 4.5 per cent in 1939. Rising bank deposits reduced the yield further to 3 per cent in 1942. The discount rates of the central bank declined from 8 per cent in 1932 to 2⅛ in 1941. The short-term rates of the private banks fell correspondingly. The result was a marked decline in interest income. The property holders who lived mainly from interest income protested[6] but their complaints were disregarded. A rapidly rising public debt in the face of drastically reduced rates of interest testified to the effectiveness of governmental control of money and capital markets.

Similarly, shareholders were not permitted to benefit fully from the rising net income of corporations. The dividend limitation law of 1934 compelled corporations to pay any excess over 6 (or 8)

6. Cf. "Eine Neue Zinsetappe," Bank-Archiv, January 15, 1941.

per cent to a government fund. Excess dividends were invested in government bonds in the name of the shareholders. Yet this fund remained small: total payments from 1934 to 1940 did not exceed 108 million marks. A portion of these accumulated dividends was disbursed in the form of non-interest bearing certificates; the remainder was kept by the government for "the duration of the war." Although not many "excess" dividends were paid to the government, the law of 1934 set an effective upper limit upon dividend payments. For the actual rate of dividends of corporations rose from 2.9 per cent in 1932–33 to 5.6 per cent in 1938–39. Hence most of the dividends paid remained below the maximum set by the government.

Lower rates of interest and limited dividends at a time of rising net profits produced a marked increase in the undistributed profits of corporations. Official sources estimated that undistributed profits amounted to only 170 million marks in 1933. They rose to 1,200 million marks in 1935 and 3,420 million marks in 1938. This remarkable advance exceeded by far the actual dividend payments, which amounted to 1,200 million marks in 1938. In other words, undistributed profits were nearly three times as large as the dividend payments to shareholders.[7] The Nazis welcomed and intensified the corporations' policy of keeping the major portion of net profits in the business. The government closed the capital market for many years to corporations, compelling them to rely upon their own resources. Government armament orders and new projects called for expansion and investment of capital. The financing of such projects was to a large extent accomplished by ploughing profits back in the business. As a result capital formation increased rapidly at the expense of the consumptive portion in property income.

Yet the Nazis had to modify their policy of holding dividend payments down. The boom of the "free" security market called for a greater supply of shares. Corporations were permitted to issue more shares on the basis of their increased assets. But not many availed themselves of this opportunity. The 10 per cent capital-issue tax was an effective deterrent. Instead of lowering this tax, the Nazis imposed a dividend tax in 1941 which repealed

7. In addition, undistributed profits of 1,000 million marks were made by individual proprietorships and partnerships. This increased the total of undistributed profits to 4,420 million marks in 1938. Cf. "Selbstfinanzierung und Kapitalmarkt," Bank-Archiv, 1941, p. 174 ff.

the dividend limitation law of 1934. The revenue from the new dividend tax was of small import, however. The law offered corporations three alternative lines of action: to write up their capital, build up undistributed profits as in the past, or pay the new tax. The majority of the corporations accepted the first two alternatives. About 30 per cent of the joint-stock companies translated some of their reserves into capital stock. These companies represented 59 per cent of the total stock.[8] Most of the "baby shares" were issued to the existing stockholders without payment. But dividends rose merely by 13 million marks, which was a small portion of the total dividends received. Hence increase in capital stock did not reverse the policy of discrimination against prospective consumers of property income.

What lessons can be drawn from this line of profit policy? In the first place, the Nazis refrained from a fundamental change in the formation of property income in Greater Germany. Capital invested was recognized as the major source of property income. The connection between the private property structure and the formation of income from property, typical for private capitalism, prevailed throughout the Nazi regime. In the second place, the Nazis interfered deliberately in the distribution of realized property income among the various groups of owners. Whoever was suspected of consuming a share of his rent, interest or dividend income had to face a persistent governmental discrimination. In fact, the government established two different groups: the "esteemed" and "despised" receivers of property income. The former group of active producers and investors was given the opportunity to transfer a share of income to themselves which otherwise would have gone to the rentiers.[9] But the federal treasury also benefited from this governmentally sponsored income transfer between owners, for the extraordinary fall in the rates of interest reduced the burden of servicing the public debt.

In the third place, the goal of the income transfer was to

8. H. W. Singer, "Recent Conditions in Germany," Bulletin, London and Cambridge Economic Service, 1943, p. 88.

9. In effect, this governmental discrimination favored the upper class and hurt the middle class, because the largest producers and investors alone got the full benefit of the income transfer. Most of the rentiers, however, belonged to the middle class. Hence the discrimination between income receivers corresponded to the separation of owners into desirable and undesirable property-holders. Cf. Arthur Schweitzer, "Big Business and Private Property under the Nazis," Journal of Business, April, 1946.

increase the formation of capital. The "esteemed" group of income receivers had to reinvest its capital in governmentally acceptable projects. The lines of investment became increasingly determined by the government. Indirect control was exerted through placement of government orders for materials and plants, as well as through suppressing demand of civilian producers and consumers. Direct control of investment became the function of the government agencies that allocated materials and manpower. Requests for industrial construction permits, for instance, were scrutinized more effectively with each additional year of war. This is evident from the decline in the physical volume of total construction, which fell from 13 billion in 1938 to 3.8 billion marks in 1944.[1] Finally, the functions involved in the formation and reinvestment of capital were divided between big business and government agencies. Private concerns were usually limited to direct investment of undistributed profits. Sale of industrial bonds was permissible only for a few large concerns. Hence the banks almost lost their customers in the industrial field. The funds of banks and insurance companies had to be invested in government bonds and bills. When the war ended, about 80 per cent of the assets of banks and insurance companies were invested in government securities. Indirect investment had developed into a governmental monopoly. This was exercised by the central bank, which regulated the capital and money markets. It was through the effective control of these markets that the government increased the national debt from 37.3 billion marks in August, 1939, to 400 billion marks in June, 1945,[2] without a decisive effect on price levels. For indebtedness was the preferred method of Nazi war finance, confiscatory taxes and expropriation being primarily practiced in the Nazis' empire.

Control of Profit Margins

How did the price commissioner handle profits through price control? Four lines of actions can be discerned. These involved freezing, reducing, manipulating and determining of profits. Actually, freezing of profits at the prevailing level of September, 1936, was merely a preliminary step: it laid the foundation for an

1. Calculated in prices of 1938 and given in "Die Deutsche Industrie," a captured manuscript, quoted in The Effect of Strategic Bombing on the German War Economy, p. 55.

2. Economist (London), November 20, 1943, and September 29, 1945.

extensive determination of prices and profit margins. Reduction of profits was accompanied by governmental subsidies. Both became effective means of equalizing the rate of profits between firms and industries. In consequence, the profit policies of the price commissioner can be discussed under three headings: equalization, manipulation and determination of profits.

Equalization of the rate of profits began with government subsidies as well as with reduction of profits by government actions. Industries producing substitutes or military equipment could and did receive subsidies. Most of them were granted indirectly, either through favorable prices or long-term purchasing contracts concluded between producers and government agencies. Cash subsidies were paid to producers to prevent losses and assure reasonable profits. The various forms of government subsidies fulfilled two functions. On the one hand, costs of experimentation in new fields and products were shifted to the government through subsidy payments; on the other, rising costs of production in many cases did not lead to higher prices, the increasing costs being either taken over by the government or shifted to more favorable producers. The groups suffering most under increasing costs were farmers, as well as coal and iron producers. During the war, government subsidies rose tremendously. Premiums paid by the state were estimated at 1000 million marks annually.[3] This amounted to nearly 10 per cent of the total receipts from farm sales. Rising costs in the coal mining industry were compensated in 1940 and 1941 by increased export prices. When this was no longer possible, the coal concerns received a government subsidy. The British military government in 1945 found a coal price of 18 marks per ton for the home market, whereas the cost of production had risen to 50 marks per ton. Hence the longer the war lasted, the more did productivity of labor decline and subsidies rise. No wonder the Nazis tried all possible devices to shift a part of the increasing cost to other producers who were more favorably situated. This gave rise to a deliberate policy of equalizing the rate of profits between firms and industries.

Inter-business payments originated in the fields of agriculture and imports. As early as 1934, producers of milk for consumers compensated producers of processed milk for their low prices.

3. "German Europe: Controlling Prices," Economist, October 31, 1942, p. 545.

Importers had to pass on a portion of their profits to home producers. In 1935 the well-known "export tax" was introduced, through which the home industries paid a part of their profits to governmentally recognized exporters. With the beginning of 1937 sugar refineries compensated beet producers, breweries compensated barley producers, wheat flour mills passed on a part of their profits to rye flour mills. Costs of transportation were shifted from producers to dealers. Industries with high profits were compelled to reduce their prices. For instance, chemical firms had to reduce the price of fertilizers repeatedly so as to help the farmers. Producers of marked-up products had to reduce prices in order to increase the profit margin of dealers and lower the prices for consumers. Similarly, vertical combines were urged to equalize profits within their spheres of influence. For instance, in the iron and steel industry prices of products were kept almost stable, though the cost of production of crude steel had risen greatly. The steel combines made great profits in steel products, but lost heavily in crude steel.[4] Under the direction of the price commissioner, steel producers had to use excess profits in some plants to offset their losses in others. Incidentally, this intensified the prevailing tendency to vertical combinations. Consequently, rising costs were absorbed through equalization payments which became an important feature of price fixing. Such payments could be made within trusts or combines, between firms in related branches, or between whole industries. Payments could appear as a reduction in prices, a government tax, a surrender of profits, or a change in accounts between subsidiaries in a combine. Whatever their form, loss of profits for one business became a "subsidy" for another business. Through these inter-business payments, the price commissioner equalized the rate of profits between firms and industries. Although limited in scope, equalization payments prevented the more striking cases of an unequal distribution of profits that resulted from governmental planning and direction of the economy. But the price commissioner reached the limit of this policy in the first year of the war: the need for cost absorption exceeded the opportunities of equalization payments between concerns. Hence the government had to increase its subsidies.

Quantitatively more important was the determination of

4. "Die Ertragslage der Schwerindustrie," Wirtschaftskurve, May, 1940.

profit margins through government price fixing. Increases in prices after the price-stop decree of September, 1936, induced the price commissioner to handle profit margins in three different ways. Requests for increased prices were refused, if the profit margins of firms were relatively high. Hence high profits became an absorber of increasing costs. But when the rise in cost was continuous, as in the case of imported goods, or when profits could not absorb increasing costs, the commissioner pursued a policy of stable profit margins. Increased cost could be passed on to buyers, but the profit margin had to be kept unchanged. This abolished the traditional practice of calculating profit margins as a standard percentage of the price. Stable profit margins even under conditions of rising prices prevailed for a considerable section of the economy prior to 1941.

Another rule related to products not formerly produced in bulk. This was a common condition in the substitute and in most armament industries. A modified cost-plus-profit price was introduced, first in construction and electricity and then extended to all firms filling orders for the government. This cost-plus-profit price was actually a governmentally calculated price.[5] Two rules were applied by government agencies. A list of items, called "necessary cost," could alone be included as overhead cost in the price; all other items were rejected. The most important items rejected related to inefficiency or prices of raw materials and wages paid above those fixed by the government. Moreover, the recognized profit margin had to be composed of two elements: a "wage" for the entrepreneur and interest for the total capital invested. The rate of interest acceptable was not to exceed the average effective rate of long-term government bonds.[6] When the prices were calculated in 1938, this rate was 4.5 per cent. These two rules had several beneficial effects. Cost-plus-profit prices were no longer a means of squeezing the treasury. Instead, two forms of incentives were built into the calculated prices. Any producer whose actual cost was below the "necessary" cost could keep the difference. Similarly, a producer who paid less than 4.5 per cent for capital borrowed realized a gain. These factors amounted to an incentive for increased efficiency. Yet this was coupled with an

5. Leonhard Miksch, "Vom Preisstopp zur Kostenkontrolle," Wirtschaftskurve, August, 1939.

6. Leonhard Miksch, "Der Zins als Kostenfaktor," Bank-Archiv, December, 1938.

attempt to make producers a party in wage and price control. Whoever filled government orders and paid more than the official prices and wages had to bear the difference himself. This was a fairly effective device, introduced in September, 1939, to check the circumvention of wage and price controls and integrate the various forms of government planning and direction.

The limitation of the cost-plus-profit price related to the spread of cost between firms in an industry. The government fixed a uniform price on the basis of average "necessary" cost in the industry. Essential producers with higher than average cost could receive a subsidy, whereas non-essential producers were urged to shift to other products within their capacity. Producers with less than average cost realized a "differential" profit. With the beginning of the war, the Nazis objected to such profits. The war economy decree of September 4, 1939, stated the principle that nobody should profit from the war. In one of his speeches Hitler threatened to behead all war profiteers. The demand for skimming off war profits became general, just as laborers were made to forego their overtime payments.[7] Hence the ground was laid for a shift to an overall fixing of total profits realized by firms.

On the whole, fixing of profit margins through price control was fairly successful. Three lessons emerge from this experience. First, the policy of permitting necessary price changes while stabilizing profit margins severed profits from their close association with variations in prices. Profits ceased to be a product of prices. Government policy transformed profits into either a standardized income of a base year or a minimum income of capital invested. These actions put a floor under the profit margins of producers. They also eliminated the risk that price declines might reduce or eliminate profit margins. Yet under conditions of full employment the problem of the price commissioner was how to prevent producers from calculating profits as a standard percentage of prices. Strangely enough, the price commissioner utilized a peculiar tax device for his purposes. The treasury had compelled businessmen in 1935 to keep books on all incoming and outgoing transactions. These books provided the evidence as to how much turnover tax a firm had to pay to the treasury. Price enforcing officers consulted these books on transactions. They

7. "Die Abschöpfung kriegswirtschaftlicher Differentialgewinne," Bank-Archiv, November, 1939, p. 526.

compared the books of firms, checked upon the actual prices charged, and thereby determined the profit margins received by sellers. Hence the danger of discovery was great and most of the firms accepted the stable profit margins in their price calculations. Yet fixing profit margins did not limit the total profits realized by producers in a year. It merely determined the profit per unit sold. With the beginning of the war the Nazis became concerned over the total profits of producers.

A similar success was scored, secondly, relative to the cost-plus-profit prices. The Nazis licked two difficulties of this method of pricing. The standardized cost accounting system, imposed upon business in 1937, gave price offices full opportunity to check upon the actual costs of production. The concept of "necessary cost" was based upon actual cost; both enabled the Nazis to eliminate the producers' practice of including simulated cost in their prices. Similarly, the "plus profit" item was replaced by governmentally calculated profits as a percentage of capital invested, instead of the cost of production. Two other difficulties remained, however: the spread of costs between producers, and differences in the degree of utilizing capital. In averaging the "necessary" cost of production and granting an average profit on capital invested, the Nazis permitted the most efficient producers to realize a special profit. Hence it was excess profit, resulting from efficiency, not from simulated costs of production, that induced many Nazis to attack this method of pricing war materials.

In the third place, the attempts to equalize the rate of profits between fields of investment were widely opposed by businessmen and regarded with misgivings by Nazis. Clearly, comprehensive direction of markets and investment by the government had stifled the inherent tendency towards equalization of profit rates. On the contrary, many a governmental action created or intensified disparities in the rate of profits realized by producers. The natural thing for the Nazis to do was to make equalization of profits a function of the government, but the two methods selected for this policy were not quite satisfactory to the Nazis. To be sure, cost absorption was enforced through the imposed cost accounting and pricing systems; yet under conditions of rising costs the profit opportunities declined and at the beginning of the war the Nazis were still reluctant to pay the price demanded for cost absorption by big business: penetration into the fields of small business and

increased profits through vertical combination. Equally, the Nazis administered inter-business payments successfully through equalization funds. Rising costs, however, limited the amounts of profits available for payments. The Nazis did not conclude that equalization was impossible but that better methods must be found to pursue the same policy. For they were determined to reduce government subsidies by shifting more profits between producers.

The Abortive Profit Ceiling

The new policy adopted aimed at a fixing of the total profits realized by a firm, which was to be added to the fixing of profit margins for individual products sold. The new policy was to avoid the excess profits accruing to the most efficient producers in cost-plus pricing, and strengthen the policy of equalizing the rate of profits between fields of investment. The new policy was called "profit stop"; actually, it introduced a form of ceiling upon yearly profits of concerns.

Ceilings upon total yearly profits were preceded by two new theories. One gave the reason, the other tried to justify the government ceiling on total profits. The crucial point, we are told,[8] in price and production policies is the effective direction and reduction of demand. Rationing limits the demand for consumers' goods; allocation limits and directs the demand for producers' goods. Government permits introduce a new system of distribution for goods: effective demand is determined by permits as well as by the income and desires of buyers. Permits reduce total demand beyond the limits set by desires and income. In effect, permits nullify the impact of excess purchasing power upon demand and prices. Hence permits adjust demand to the reduced supply and thereby provide the basis for effective price control. Any war, however, creates a tendency to increasing costs of production. This is the result of various factors: use of substitute materials, utilizing less productive workers, assigning orders to less efficient plants, producing new kinds of products, and additional overhead cost for organizational adjustments. Higher costs of production exert pressure upon fixed prices. The price commissioner will be called upon to permit rises in prices. The author expected in the

8. Leonhard Miksch, "Mark und Marken," Wirtschaftskurve, May, 1940.

spring of 1940 that the rise in cost would be limited; the pressure would not constitute a serious threat to the "stable" price level. A year later, however, the price commissioner was faced with a tremendous pressure upon prevailing prices and a marked deterioration in the quality of goods. He was searching for a device to offset the impact of increasing costs upon prices.

The second theory gave a new interpretation of the sources of profits. It distinguished between two kinds of profits according to their origin.[9] Profit of superior performance (Leistungsgewinn) results from great efficiency of enterprises. Differential profit (Differentialgewinn), however, is the product of successful speculation, advantages of location or transportation, wage differentials, or monopolistic agreements among producers. These two kinds of profits are not of equal significance in the economy. Profits of superior performance are justified, because they spring from managerial ability, organizational improvements, and technological advances. These achievements should receive compensation in the form of reasonable profits; but the same cannot be said for differential profits, because owners reap products in an area which they have never cultivated. Hence differential profits should either be paid to the treasury or be utilized in plants for essential investments which have no profit expectations. This profit theory, in effect, suggests that only managerial ability and plant efficiency should furnish a justification for profits, not invested capital in its manifold forms.

The price commissioner did not quite follow this theory when he issued his "profit stop" decree in March, 1941. He distinguished between permissible and excessive profits. The latter had to be surrendered. Permissible profits had to be equal to the profits of a normal year prior to the war. For industrial concerns permissible profit was influenced also by turnover. If capital was turned over once a year, the permissible profit before taxes should not exceed 4.5 per cent of the capital employed. To this could be added 1.5 to 3.5 per cent as a risk premium and 1 to 2.5 per cent as a wage for entrepreneurs.[1] Although larger industrialists were given a chance to negotiate their permissible profit with the price commissioner, his intention was to set a ceiling upon the rate of profits and thereby

9. Ludwig Preller, "Differentialgewinn," Soziale Praxis, 1941, p. 91 ff.
1. For details see Ernest Doblin, "The German 'Profit Stop' of 1941," Social Research, September, 1942.

limit the total amount of profits available to owners. A ceiling upon profits was not an end in itself, however; it was utilized as a means of easing the pressure upon fixed prices[2] and reducing the volume of government subsidies. Producers had to pay the excess profits of 1940 as a tax to the price commissioner, but excess profits of 1941 had to be translated into lower prices.

The profit ceiling policy failed. The price commissioner, an old *Gauleiter* of the party, fell in disgrace and was dismissed by Hitler. Three repercussions combined to cause his downfall. Administratively, the new method of regulating profits involved extensive red tape. Firms had to (a) compute their profits according to the new formulae, (b) calculate their prices anew, (c) recompute their taxes for 1940, and (d) file a return on profits and prices with the commissioner six months after the end of the business year. This additional administrative burden came at a time when office help was hard to get. Economically, the computation of permissible profits as a percentage of capital invested eliminated the link between output and profits. The volume of goods produced, in spite of the reference to the turnover of capital, was no longer closely connected with the total profits obtainable. Hence producers lost interest in speed of production, lowering of cost, and efficient organization of plants.[3] They could secure their "permissible" profit by less than exceptional efforts. Hence the profit ceiling reduced the effectiveness of the profit stimulus. The price commissioner, in his economic naïveté, had sinned against one major tenet of the Nazi economy: to get the highest total output from the available resources. Politically, the price commissioner had incurred the opposition of other party leaders. He began to collect quasi-taxes, gave directives to government agencies placing orders, and tried to establish the requirements of price fixing as the superior goal of the economy. Some Nazi top leaders therefore supported the opposition of big business against the price commissioner. By obtaining the political support of some powerful Nazis, big business was able to get the policy of profit

2. In March of 1941, when the "profit stop" decree was issued, not less than 3,975 shopkeepers in Berlin were convicted for violating the price regulations. Cf. H. W. Singer, "The German War Economy in the Light of Economic Periodicals," Economic Journal, 1942, p. 26.

3. Some periodicals complained of a reckless inflation of cost. See Singer, ibid., p. 28.

ceiling removed. The price commissioner was dismissed.[4] The profit stimulus was restored: the Nazis recognized it as the most effective inducement to maximum armament production.

Profit Incentives in Price Control

Dr. Fischboeck now became price commissioner. He was a former Austrian banker and cartel man, who was well-known to the German steel industrialists. The new commissioner acted decisively: price control was overhauled; profit taxation was severed from price control and transferred to the treasury.

The new excess profit tax cannot stand comparison with the corresponding tax in the United States. Tax base, rate, exemptions and deductions of the tax of April, 1942, were all favorable for producers. Concerns with net income of less than 30,000 marks were exempted. This limited the tax to 30,000 of about 290,000 firms. "Excess profits" were defined as earnings exceeding 50 per cent of the profits in 1938 (or the average of 1936–38). The tax rate was 25 per cent for private firms and 30 per cent for corporations. Not all the taxable profits, however, had to be paid to the treasury. Deductions were granted to firms who invested portions of the tax in desirable projects, reduced prices, or spent it for experimental work. Although the generous exemption and base were reduced somewhat in 1943, it is unlikely that the excess profit tax netted the treasury substantial revenue.

The overhauling of price control did away with the idea of price stability. The new goal of the price law of 1942 was to facilitate the production of essential materials. Hence three new principles were introduced into price control. Multiple prices for the same product sought to overcome the spread of cost among producers; prices were permitted to rise with increasing cost; incentives were built into the system of fixed prices so as to increase production.

The system of multiple prices, introduced in 1942, was limited to armament products. It replaced the cost-plus-profit prices, because the comprehensive cost studies were said to be too cumbersome. Multiple prices were based upon different levels of efficiency in an industry. This notion grew out of the experience

4. The eclipse of Price Commissioner Wagner coincided with the rise of Gauleiter Sauckel, who took over effective control of the labor market with the help of the Labor Front.

of cost prices. Already the profit stop decree had authorized the price commissioner to allow higher "permissible" profits, if they were a result of efficient management; but this permission remained on paper, because firms were not then classified into efficiency groups. Such groupings of firms came with the price law of 1942. Gradually five different price groups were set up, which covered in 1943 about 70 per cent of all armament products. Prices were fixed by government agencies, not negotiated with firms. Producers, however, could elect their price group. The choice, of course, was influenced by two kinds of government action: inducements and punitive cost investigations. When firms selected the lowest price, they were relieved from the excess profit tax. A specific profit incentive for efficient producers was thus built into the system of multiple prices. When firms refused to elect a low price, government inspectors checked plants, discovered sources of waste, and caused appreciable reduction in cost. The result was a tendency for producers to shift to the lowest possible price group.

Multiple prices enabled the government to achieve two goals. In shifting from average cost to multiple efficiency prices, the government was able to reduce the prices for war materials purchased. The lower prices of the most efficient firms, however, shifted a portion of the "differential profits" from the producers to the government. Moreover, firms with high prices invited government inspection and subsequent cost reduction. Hence fixed multiple prices facilitated the drive for "rationalization" of less efficient firms, and thereby contributed to the paramount goal of maximizing armament production.

In the field of civilian products, however, prices continued to be based upon extensive cost studies. A trend towards an increasing variation in cost between firms was discovered. This produced changes in permitted prices. When costs had increased, the price commissioner allowed a rise in prices. When cost had been reduced through "rationalization," the commissioner ordered a lowering of prices. His aim was to offset the rise by an imposed decline in other prices and thereby nullify the net impact of price changes upon the price level.[5] Cartels and groups were ordered early in 1943 to pre-

5. This policy was accompanied by standardization of products, which were required to have the same quality. Cf. "Umschau," Frankfurter Zeitung, October 10, 1942. Freezing of quality standards was limited to a few industries, however, and lower qualities of civilian goods became the general practice in the last years.

sent proposals for price reductions. The commissioner's order to reduce prices of individual firms was widely publicized. Piece rates of wages were cut in 1943 by government order; the reduced wage cost had to be reflected fully in lower prices. Yet all these efforts did not keep the price level stable. Even the official cost-of-living index rose during the war by 14 per cent.[6] Prices of clothes increased by 38 per cent in the official index. In spite of all punitive and propagandistic actions of party and government, people increasingly lost confidence in the value of money as prices rose.

The partial rise in civilian prices induced the government to grant more premiums to producers. Payments were given primarily to farmers, and were usually made dependent upon some additional actions of producers: to cut down their self-consumption and deliver more to the regular channels of the market, or to produce more goods of a specific kind on the available acreage. These specific premiums were accompanied by general premiums only if adverse weather affected all producers alike. The payments led to a rapidly rising rate of government subsidies, and a remarkable discrepancy between producer and consumer prices in food, coal and steel. The result was a peculiar kind of dual price system in the field of civilian products. The multiple prices in the military and the dual prices in the civilian sectors exerted a different influence upon the price level. In the military field, the government was the sole purchaser and effective cost inspector. It had complete control over demand and supply of the products and could compel producers to sell at the lowest price. In the civilian field, however, there were many producers and consumers. Inspection and reduction of cost was here a slow process. Consumers wanted goods and adopted the well-known attitude of considering the price commissioner as their enemy. Gradually, neither supply nor demand of civilian raw materials and products could be fully controlled by the government. Hence, even before military defeat, price control failed partially in the civilian sector of the economy.

Two factors were responsible for the partial failure of price fixing. On the one hand, the supply of civilian products and related raw materials declined rapidly on account of the loss of the empire and increasing air attacks. On the other hand, the Nazis reëstablished the connection between prices, volume of production, and

6. H. W. Singer, "Recent Conditions in Germany," London and Cambridge Economic Service, October, 1944.

the profit stimulus. Profits of essential producers ceased to be the absorber of increasing cost.[7] Additional items of cost led either to higher prices or to rising government subsidies. Similarly, a larger volume of products and lower "overhead" or subsidies caused a rise in yearly profits. For in the period of total mobilization, when maximizing of essential production was imperative, the Nazis acknowledged by their actions that the traditional or special profit stimuli had proved to be a stronger inducement to managerial efficiency than all Nazi violence and ideals.[8]

How did recognition of the profit stimulus affect price control? When the price commissioner permitted a rise in some prices, many producers clamored for the return to "the free price mechanism." Even the *Frankfurter Zeitung* campaigned for a general rise in food prices in the last days of its existence. But the price commissioner rejected firmly the demand for a general price rise, and insisted that higher prices would merely transfer the excess purchasing power from the buyers to the sellers. The transfer itself would not increase production; it would certainly produce a general price inflation. The subsequent actions of the commissioner and other agencies were able to head off a general price inflation.

The Nazis had to face a peculiar form of inflation. For many Nazis and their economists, inflation was exclusively a price problem. Regulate all markets, fix all prices, then — they believed — inflation cannot occur. Consequently, they decided to leave the traditional income structure undisturbed. The formation of excess purchasing power and monetized capital can be avoided through government borrowing. The Nazis ridiculed all proposals for compulsory savings, and deliberately decided to leave the act of saving uncontrolled. The demand for a special tax upon saving accounts was rejected. Instead, many inducements were offered to increase savings, like the "iron savings" plan and the invitation to deposit depreciation accounts with the government. These schemes offered reduced tax obligations for increased savings, but their success was very limited.[9] The schemes falied to absorb all

7. The squeeze upon the trader's margins, however, was greatly intensified during the last two years of the regime. Cf. "Kostenkontrolle im Grosshandel," Frankfurter Zeitung, September, 12, 1942.

8. The same treatment was refused to laborers and small but nonessential firms; they felt the full force of the increasing Nazi violence. Cf. H. Grimpe, "Der unentbehrliche Kleinbetrieb," Die Deutsche Volkswirtschaft, 1944, p. 696.

9. Otto Nathan, The Nazi Economic System, Durham, 1945, pp. 297 ff.

excess purchasing power, nor did they divert all monetized capital to the treasury. Hence inflation developed in spite of the extensive regulation of the capital and money markets.

The quantity of money in circulation increased greatly. Excessive borrowing by the government destroyed the confidence of many in the stability of the banking system. In spite of many official threats, people began to hoard notes.[1] Many firms invested their funds in liquid assets. This prevented the banks from absorbing all government bonds. The treasury was compelled to incur a rapidly rising short-term debt. Hence distrust in the value of money and government bonds and a change in war finance was caused by the "purely monetary" inflation. Excess purchasing power and liquid assets gradually undermined the monetary system, which began to disintegrate even before the military defeat of the Nazis.

At first the governmental price fixing neutralized the price structure against inflationary pressure, but the uncontrolled funds caused a special price inflation in securities from 1940 to 1942. After some hesitation, the stock markets were extensively regulated like all other markets. Speculation in real estate led to a general prohibition of changes in ownership, except when agriculturally beneficial. In spite of the heavy penalties, barter trade gained in significance. The inflationary pressures proved stronger than the market and price controls of the Nazis. Barter trade established a new market that was beyond the official controls. In 1944 the Nazis realized that they could not suppress barter trade and recognized some forms of such trade, but they fixed the values of goods exchanged. Premium payments were increasingly paid in kind: whoever delivered more milk could receive higher feed rations. Barter exchanges were established for equipment, tools, and also for consumer goods.[2] But control of barter trade was unsuccessful; and barter proved that the controlled price structure could not be immunized against inflation. When the Nazi power crumbled, barter trade superseded regulated marketing, and the controlled price structure disintegrated.

1. See the speech of Funk on "Sparen im Kriege," Frankfurter Zeitung, June 29, 1943.

2. "Neue Formen des Warentausches," Berliner Boersen-Zeitung, August 13, 1944.

Conclusions

Under conditions of central economic planning, determination of profits became the function of government. Similarly, the Nazis determined the uses to which these profits were put. In both respects, however, the Nazis failed partially. A ceiling on yearly profits failed because the Nazis were compelled to retain the profit stimulus as an inducement to owners for high efficiency and maximum output of essential goods. Effective control over investment or consumption of capital failed in part because the act of saving was not controlled. "Free" savings and lack of effective control of disinvestment of capital caused excessive purchasing power and monetized capital, in spite of extensive control of money and capital markets, in spite of price fixing and governmental allocation of agents of production. In consequence, the Nazis could not achieve full coördination of profits with central economic planning.

The lack of coördination involved two drawbacks — for economic planning. On the one hand, the volume of property income (e.g. yearly profits) could not be known and determined in advance. This was responsible for the "purely monetary inflation." Actually, it caused the price boom in securities and contributed to the loss of confidence in the banking system. On the other hand, the opportunity for rising yearly profits contributed to a governmentally permitted rise in prices. Hence price and money controls suffered from the lack of coördination between profits and economic planning.

One has to realize, however, that these setbacks were just temporary defects which could have been overcome in the absence of military defeat. Improvements in excess profit taxation could have reduced the dangers springing from the uncontrolled portion of yearly profits. Extension of multiple prices to civilian goods could have reduced the impact of uncontrolled profits upon the price structure. Continued property transfer in conquered lands to nazified concerns would have absorbed much of the monetized capital. Improved methods of borrowing and some new forms of compulsory saving would have neutralized much of the excessive purchasing power, at least as long as the rations of 1940–42 prevailed. None of these improvements could be attained in the period of defeat.

Two inferences can safely be drawn from the Nazi planning

experience. Central planning and private profits developed as the two typical features of modern state capitalism.[3] There is no reason to expect that one will absorb the other, for in the framework of such an economy they can be made compatible; but there will always be practical difficulties in adjusting the recognized profit stimulus and total profits to the requirements of central planning. Such difficulties can be overcome without endangering central planning as long as the ruling party or army is in command of the state and not threatened by defeat.

ARTHUR SCHWEITZER.

UNIVERSITY OF WYOMING

3. State socialism does not face the same problem. In dictatorial state socialism, private ownership in the means of production is eliminated and with it the profit system. Adequate incentives for workers and managers is the problem that remains to be solved. Democratic state socialism retains private ownership, even in nationalized industries, but the owners are reduced to rentiers. The connection of their income with the volume of production and efficiency of management has been severed. Hence in neither system is there, in principle, a need to adjust profits to the requirements of planning.